MEMORANDUM OF LAW

DATE: April 16, 1991

TO: D. Cruz Gonzalez, Risk Management Director

FROM: City Attorney

SUBJECT: Industrial Leave

Your memorandum of March 20, 1991, poses two questions regarding the status of pre-tax contributions and tax withholdings while an employee is on industrial leave. Your questions and our answers are as follows:

1. While an employee is on industrial leave can their ┌sicσ pre-tax contributions (Flexible Spending Accounts (FSAs), Dependent Health Insurance, 401(k), Deferred Compensation) be continued?

Answer: Yes. The industrial leave program is a benefit provided to employees in lieu of the injury leave program which was phased out in 1976. It is an unfunded health and accident plan in the nature of a workers' compensation plan. As such, the benefits received are not subject to state and federal income tax. Importantly, the benefits provided pursuant to this plan are intended to pay an employee a sum equivalent to his or her net take-home pay for a stated period.

San Diego Municipal Code (SDMC) section 22.1019 describes the industrial leave program. Subdivision (c) provides that "┌tσhe industrial leave benefit shall be the employee's normal compensation less current deductions for state and federal tax withholdings." Administrative Regulation No. 63.00 section 4.3 provides additional information concerning industrial leave benefits. Subdivision (a)(1) provides: "The term 'normal compensation' includes extra compensation for night or unusual schedule work shifts, motorcycle pay, emergency ordinance disposal pay, and educational incentive pay, which the employee was receiving at the time of the injury, but does not include overtime, standby, or out-of-class pay."

Subdivision (e) provides further that while an employee is on industrial leave "┌tσhe City shall continue to make the contribution towards the employee's health and life insurance coverage as if the employee was working."

In a Memorandum of Law dated July 20, 1976, this office

provided clarification concerning the handling of "other payroll benefits" in connection with the administration of industrial leave benefits. In particular, we stated that an employee on industrial leave had the right to have voluntary deductions for dependents health insurance, supplemental and additional life insurance, credit union, union dues/insurance and "other." Clearly, in light of the foregoing, dependent health insurance contributions may be continued while the employee is on industrial leave. The fact that this contribution as well as the contributions for FSAs, 401(k) and deferred compensation are on a pre-tax basis does not alter this conclusion. Each of these contributions may be continued while the employee is on industrial leave.

Support for this conclusion is found in the SDMC (section 22.1019), the Administrative Regulations (No. 63 section 4.3) and the purpose behind industrial leave. As stated earlier, industrial leave is intended to pay the injured employee a sum equivalent to his or her net take-home pay for a stated period. (Emphasis added.) Thus, although the benefits paid are not subject to state and federal income tax, these amounts are computed and deducted from the total compensation to reflect that amount which the employee would have received had the employee been paid his or her normal salary. The same reasoning applies to contributions for FSAs, 401(k), deferred compensation, and dependents health insurance. Contributions to these plans may be continued while an employee is on industrial leave to accurately reflect the sum equivalent to the employee's net take-home pay. To do otherwise would violate the purpose behind industrial leave. For example, if the injured employee were not permitted to continue these voluntary contributions, the employee would in essence be penalized. As the hypothetical attached to your March 20, 1991 memorandum suggests, employees participating through payroll deduction in either a 401(k) or deferred compensation would receive a reduced industrial leave benefit if they were not allowed to contribute to these programs while on industrial leave. Such a result violates the purpose and intent of industrial leave. Injured employees should receive a sum equivalent to their net take-home pay before their participation in the industrial leave program.

For your information, the Administrative Regulations governing industrial leave predate the 401(k) plan. The Administrative Regulations became effective July 1, 1982. The 401(k) plan became effective July 1, 1985. FSAs will be available effective July 1, 1991. In addition, although not articulated in either the Administrative Regulations or SDMC

section 22.1019, contributions to the City Employees' Retirement System (CERS) are continued while the employee/CERS member is on an industrial leave. To avoid future confusion, we recommend that the Administrative Regulations should be amended to provide clarification in the areas addressed by this memorandum.

2. While an employee is on industrial leave can their ┌sicσ tax withholdings be changed?

Answer: This question is a policy matter to be determined as a policy decision and not legal interpretation. Although Administrative Regulation No. 63.00 section 4.3(a) does provide that: " ┌tσhe injured employee shall be prohibited from amending his or her claim of deductions from the date of injury until after they have returned to work and industrial leave benefits have discontinued" there is nothing in the law which would prohibit a change in this policy.

Evidently, this policy decision was reached in 1976 when the industrial leave program was first introduced. To avoid the situation where injured employees deliberately changed their tax withholdings to inflate their industrial leave benefit, the City adopted a policy preventing any changes to their tax withholding. As stated in a Memorandum of Law dated July 20, 1976, addressed to City Auditor and Comptroller, this office indicated that: "The number of dependents shown on the W-4 should, to be consistent, remain unchanged during the period of Industrial Leave. Changing that figure would have a direct effect on the net take-home benefit and should not be permitted."

The hypothetical to your memorandum dated March 20, 1991 suggests, however, that the prohibition against changing tax withholdings may still result in inequitable results. Employees choosing to have additional withholding taken from their paycheck in lieu of paying quarterly estimated taxes will have a reduced industrial leave benefit. Conversely, those employees claiming several exemptions in order to avoid having any federal or state taxes withheld will have an inflated industrial benefit.

In light of the foregoing, the City may wish to reevaluate the current policy prohibiting any change in withholding while on industrial leave. A workable guideline allowing a change in withholding could be fashioned. To assist in this decision, we suggest that representatives from the City's Risk Management Department, Auditor's office and Manager's office meet to discuss the merits of any proposed policy change.

JOHN W. WITT, City Attorney

By

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